Got coverage? What to consider in the wake of the Ohio Supreme Court's ruling on Ohio Northern University v. Charles Construction Services, Inc.

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On October 9, 2018, in *Ohio N. University v. Charles Constr. Servs., Inc.*, Slip Opinion 2018-Ohio-4057, the Ohio Supreme Court ruled that property damage caused by a subcontractor's allegedly defective work was not covered by a standard commercial general liability (CGL) insurance policy held by a general contractor. This ruling augmented the Court's prior holding in *Westfield Ins. Co. v. Custom Agri Systems, Inc.*, 2012-Ohio-4712, in which it found that a standard CGL policy did not provide coverage for property damage caused by the allegedly defective work of the insured contractor. The Court's reasoning in both cases was the same: defective work is not an "occurrence" as defined by a standard CGL policy, and, therefore, defective work does not trigger coverage for property damage under a standard CGL policy.

In the case, Charles Construction Services, Inc. (Charles Construction) contracted with Ohio Northern University (ONU) to construct The University Inn and Conference Center, a luxury hotel and conference center, on ONU's campus. Charles Construction obtained a CGL policy from Cincinnati Insurance Company (CIC) for the project. After completion, ONU discovered water damage caused by hidden water leaks and, upon further investigation, discovered serious structural defects. ONU believed that the water intrusion and structural defects were caused by the defective work of Charles Construction and its subcontractors and, thus, filed suit. Charles Construction submitted a claim under its CGL policy requesting that CIC defend and indemnify it. CIC intervened in the action in order to pursue a declaratory judgment, stating that CIC did not have a duty to defend or indemnify Charles Construction. ONU and CIC submitted cross motions for summary judgement arguing for and against CIC's duty to defend

and indemnify Charles Construction. Upon review of the cross motions, the Hancock County Court of Common Pleas found for CIC. The Third District Court of Appeals reversed. The Ohio Supreme Court accepted CIC's appeal.

Based on the following analysis, the Court then reversed the holding of the Third District Court of Appeals. The standard CGL policy held by Charles Construction covered property damage only if caused by an "occurrence." Charles Construction's standard CGL policy defined "occurrence" as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions." As in *Custom Agri*, the Court defined "accidental" as "unexpected," as well as "unintended" and stated that an "accident" must be "fortuitous." Through this lens, the Court determined that a subcontractor's defective work was not "fortuitous" but was a "business risk" as defective work is a normal, frequent and predictable consequence of doing business that an insured could manage. No "accident" meant no "occurrence." And no "occurrence" meant no coverage under standard CGL policy held by Charles Construction. Moreover, the Court stated that the products-completed operations hazard provision and the subcontractor language contained in the CGL policy, which would have covered a subcontractor's defective work, had "no effect" as there was no "occurrence" to trigger coverage in the first instance.

In closing, the Court explained that its reasoning was adopted from a 2008 Arkansas Supreme Court decision holding that a subcontractor's defective work was not unexpected and, thus, not covered by a CGL policy. In response to that decision, the Arkansas legislature enacted a statute requiring all CGL policies offered for sale in Arkansas to define "occurrence" to include "property damage . . . resulting from faulty workmanship." The Court stated that the Ohio General Assembly was free to follow suit if it were so inclined.

This decision affects both owners and contractors. Owners are affected because they now have a significantly smaller pool of funds from which to recover damages for defective work. Contractors are affected because they no longer have insurance coverage for typical property damage and/or physical injury caused by their subcontractor's defective work, even if the contractor paid an additional fee for that exact coverage. So, what's an owner or contractor to do? The answer to that question depends on the current stage of the project in question.

If the project is in its infancy and has not yet been bid, both owner and contractor are in luck. Insurers are very aware of this decision by the Ohio Supreme Court and many insurers have developed a solution. Although the standard CGL policy ISO form has not been modified, insurers have created endorsement forms that specifically provide defective work coverage to contractors for a fee. These endorsement forms restore defective work coverage by modifying the definition of "occurrence" to include defective work of the contractor and/or subcontractors. These endorsement forms essentially modify the standard CGL policy in the same manner as required in Arkansas and as indicated by the Ohio Supreme Court. Owners should consider including a requirement for such an endorsement in the insurance requirements section of the project's contract(s), as defective work coverage under a CGL policy benefits both owner and contractor. Contractors would be wise to add such an endorsement to their CGL policy whether or not they are contractually obligated to do so.

If the project has been awarded to the contractor and an endorsement returning defective work coverage was not obtained, all is not lost. Specifically, the owner can still rely on any performance bond to ensure the contractor and its subcontractor(s) construct the project per the contract documents. However, the contractor will not have defective work coverage if the language in its CGL policy is the same as that analyzed by the Court. In such a case, the insurer would not be required to indemnify or defend the contractor in a defective work lawsuit. Without a defense provided or at least subsidized by the insurer, the contractor may be incentivized to settle earlier in the process. This may save a headache if nothing else.

With all that said, owners and contractors should always obtain the applicable CGL policy for their projects and read them. It is critical that owners and contractors understand how coverage under the applicable policy is triggered, what is covered and excluded, and whether the provided CGL policy meets the requirements of the project's contract documents. Moreover, the Court's decision was based on the specific language of the CGL policy in question. If an owner or contractor finds that the applicable CGL policy utilizes language different from that previously analyzed by the Court, an argument distinguishing that policy is possible. Thus, coverage still depends on the specific language of the applicable CGL policy.

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